

Message Text

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ACTION EUR-25

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SUBJECT: GOT EFFORTS TO EASE MONEY SHORTAGE AND PROMOTE INVESTMENT

1. FINANCE MINISTER DENIZ BAYKAL ON AUGUST 29 ANNOUNCED A NEW PACKAGE OF ECONOMIC MEASURES AIMED BOTH AT ENCOURAGING SAVING AND ACCELERATING INVESTMENTS. TIGHT MONEY POLICIES INTRODUCED IN 1973 HAD DRASTICALLY REDUCED CREDIT POTENTIAL AND INVESTMENT OPPORTUNITIES. THESE INCLUDED PARTICULARLY ADDITIONAL LEGAL RESERVES WHICH BANKS HAD TO DEPOSIT WITH THE CENTRAL BANK AGAINST THEIR DEPOSIT HOLDINGS. SITUATION WAS FURTHER AGGRAVATED BY WITHDRAWAL OF MORE THAN TL 5 BILLION FROM SAVINGS AND DEMAND DEPOSITS SINCE THE CYPRUS OPERATIONS BEGAN ON JULY 20. CREDIT SHORTAGES, PRODUCTION DECLINES, AND INCREASED LABOR COSTS HAVE CONTRIBUTED TO DEVELOPMENT STAGFLATION, WITH PRICE INCREASES NOW RUNNING AT CONSIDERABLY ABOVE 20 PERCENT ANNUAL RATE. PRIVATE SECTOR HAS LONG COMPLAINED THAT LACK OF MEDIUM-TERM CREDIT

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HAMPERS INVESTMENT AND OUTPUT. THE NEW POLICIES HAVE BEEN

PROMULGATED AS AN ATTEMPT BY THE GOT TO RAISE SAVINGS (AVERAGE OF MARGINAL SAVINGS HAVE STAYED FAR BELOW PLANNED TARGETS), CUT CONSUMPTION, ENCOURAGE INVESTMENT, AND RAISE PRODUCTION (HOWEVER, SOME ELEMENTS OF THE NEW MEASURES MAY ADD TO INFLATIONARY PRESSURES).

2. THE FIRST GROUP OF NEW MEASURES AUTHORIZES AN INCREASE IN INTEREST RATES OF UP TO TWO PERCENT ON TIME DEPOSITS (INCREASE FROM FOUR TO SIX PERCENT ON ONE-YEAR DEPOSITS, FROM SEVEN TO NINE PERCENT ON TWO-YEAR DEPOSITS AND FROM ZERO TO TWO PERCENT ON COMMERCIAL DEPOSITS). INTEREST HAS ALSO BEEN RAISED FROM NINE TO 10 1/2 PERCENT ON AGRICULTURE AND EXPORT FINANCE CREDITS AND FROM NINE TO 12 1/2 PERCENT ON MEDIUM-TERM FINANCE CREDITS.

3. THE SECOND GROUP OF MEASURES AIMS AT MEETING THE LIQUIDITY PROBLEM OF THE BANKS AND ALSO CREATING AN ADDITIONAL FUND FOR THE PROMOTION OF INDUSTRIAL INVESTMENTS THROUGH MEDIUM-TERM FINANCING. UNDER THIS DECREE, BANK RESERVES DEPOSITED AT THE CENTRAL BANK AGAINST DEMAND DEPOSIT HOLDINGS HAVE BEEN REDUCED FROM 30 PERCENT TO 27 PERCENT RETROACTIVELY FOR THE MONTHS OF JULY AND AUGUST. THE GOVERNMENT HAS ORDERED THE CENTRAL BANK TO IMMEDIATELY REPAY 10 PERCENT FROM THESE ADDITIONAL RESERVES AS AN ADVANCE TO THE BANKS TO EASE THE PRESENT MONEY SHORTAGE. IT IS ANTICIPATED THAT BANKS WILL RESUME 30 PERCENT RESERVE REQUIREMENTS AGAINST DEMAND DEPOSITS AS OF SEPTEMBER 30, 1974, UNLESS THIS CONCESSION IS FURTHER EXTENDED. IN ORDER TO PROMOTE MEDIUM-TERM CREDITS, BANKS WILL BE PERMITTED TO MAINTAIN RESERVES OF ONLY FIVE PERCENT AGAINST DEMAND AND SAVINGS DEPOSITS USED TO PROVIDE MEDIUM-TERM CREDITS (AT LEAST TWO YEARS) TO SPECIFIC INDUSTRY SECTORS. THE GOVERNMENT HOPES TO MAKE AVAILABLE UP TO TL 1.5 BILLION FOR MEDIUM-TERM FINANCING UNDER THIS PROGRAM. THE GOT HAS ALSO ANNOUNCED THE CREATION OF AN INTEREST-FREE PROFIT-SHARING BOND. (THIS MAY REPRESENT IN PART A BAYKAL COMPROMISE WITH THE NSP COALITION ISLAMIC SOCIALISTS WHO TRADITIONALLY ARE OPPOSED TO INTEREST.) THIS SYSTEM WILL ALLOW JOINT STOCK COMPANIES TO ISSUE INTEREST-FREE BONDS REDEEMABLE WITHIN A MINIMUM PERIOD OF SIX MONTHS AND FOR A MAXIMUM PERIOD OF FIVE YEARS. THE BUYER, INSTEAD OF RECEIVING A FIXED RATE OF INTEREST, WILL SHARE IN THE PROFITS OF THE COMPANY FOR THE VALIDITY PERIOD OF THE BOND.

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4. ALTHOUGH NOT PUBLICLY ANNOUNCED BY THE GOT, BANK NOTES IN CIRCULATION HAVE RISEN FROM TL 28 BILLION ON JULY 19 (THE EVE OF THE FIRST CYPRUS OPERATION) TO TL 34 BILLION ON AUGUST 16. WHILE JUSTICE PARTY LEADER DEMIREL, CHIEF OPPOSITION SPOKESMAN IN PARLIAMENT, IN A BROAD ATTACK IN GOVERNMENT ECONOMIC POLICY, CRITICIZED THIS DEVELOPMENT AS INFLATIONARY, THE REASON FOR THE RAPID INCREASE IN BANK NOTE

CIRCULATION IS NOT YET CLEAR. IT REFLECTS IN PART A RESPONSE TO THE WITHDRAWAL OF DEMAND AND SAVINGS DEPOSITS BY THE POPULACE MENTIONED ABOVE. IT ALSO REFLECTS A 105 MILLION INCREASE IN FOREIGN EXCHANGE HOLDINGS DURING THE SAME JULY 19 TO AUGUST 16 PERIOD. A CONSIDERABLE PORTION OF THE INCREASE IS ALSO DUE TO THE GOT'S SUPPORT PURCHASE OF AGRICULTURAL COMMODITIES DURING THE PERIOD.
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